EXHIBIT 16
DATE 2/18/2011
HB 553

Friday, February 18, 2011

Testimony in support of HB 553

Michele Reinhart, HD 97, Missoula

I learned so much this past interim about Workers' Compensation and because there is very high turnover in the legislature, it is important to share some of this information with you to prevent an old fund from happening again. The people in this room who know about the Old Fund will not be here forever and we have to train the next generation about the worker's compensation system. One key piece of this system is the Montana State Fund, the insurer of last resort. Montana State Fund is a statutory creation. It is a quasi-state agency and private insurance company. Think of your selves as the shareholders because you dictate to this insurance company its obligations and limits and we are all on the hook if it ever again becomes insolvent. We all share the goal of ensuring that our insurance company is well managed, healthy and solvent, and that it is treating Montana Small Businesses and injured workers fairly.

1. HB 553 is about getting cost savings back to small businesses.
2. HB 553 is about ensuring more fair competition.
3. HB 553 is about trimming costs at Montana State Fund and focusing on safety.
4. HB 553 is about remembering the Old Fund and keeping our insurer of last resort solvent and having proper regulatory oversight like the private insurers.

1. Getting Cost Savings Back to Small Businesses.

- I support HB 553 because it is the vehicle to make sure cost savings from worker's compensation reform get back to policy holders.
- Plan 1, Self Insured businesses will see cost savings immediately from workers' compensation reform.
- Plan 2, Private insurers will have to pass on cost savings to their policy holders because they have to follow NCCI lost cost filings as the starting point for rates.
- Plan 3, Montana State Fund (MSF), unlike Plan 2 carriers can deviate from NCCI lost cost filings, and the State Fund did deviate recently from NCCI. NCCI recommended a 6.4% average reduction from the previous year, and MSF did a 4% average deduction instead. Nearly 70% of businesses, especially small businesses, have workers' compensation policies with State Fund. Forcing MSF to follow NCCI lost cost filings will help ensure cost savings from reform are passed along to MSF policy holders.

2. HB 553 is about ensuring more fair competition.

- Right now, private insurers have to do market conduct exams and financial exams with the State Auditor's and pay for those. State Fund does not. Since MSF behaves like a private insurance carrier, it should be subject to the same regulatory oversight.

- Right now, State Fund has 14 special class codes that private carriers do not get to use. This bill allows private carriers to use those special class codes.

3. HB 553 is about trimming costs at Montana State Fund.

- This bill trims administrative costs which used to be capped at 15%. In a move in the 1990's to privatize the State Fund, the legislature lifted the cap. Now administrative costs are at over 26%. Administrative costs include commissions paid to insurance agents; advertising and promotions at Helena Brewers' Baseball Games, Bobcat and Griz Football games and more.
- This bill caps administrative costs at 15%, but exempts claims adjusters since MSF is the insurer of last resort and needs to have sufficient claims adjusters as the number of policy holders increases.
- This bill also cuts money spent on educational and scholarships. We need to focus on getting costs down and businesses want more safety trainings and prevention to come first.

4. HB 553 is about remembering the Old Fund, keeping MSF solvent and having proper regulatory oversight like the private insurers.

- Montana is one of two states in the nation that allows a workers' compensation board (MSF's board) to set rates without any regulatory oversight.
- Recall that all Montana Taxpayers and the State of Montana are on the hook if MSF ever becomes insolvent.
- Let's never let the old fund happen again. We can protect taxpayers and policy holders by having proper regulatory oversight to make sure MSF follows its own policies and recommendations.

PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

Economic Affairs Interim Committee

61st Montana Legislature

Memo

To: Economic Affairs Committee Members
From: Pat Murdo, Staff Pat
Re: New Rate Recommendations from NCCI, Montana State Fund

The following material from Montana State Fund summarizes materials given by Montana State Fund staff to the Montana State Fund Board of Directors. At that meeting, the Board adopted the NCCI-recommended loss costs as a basis for Montana State Fund rates and then revised that rate reduction upward. Under 39-71-2316, MCA, Montana State Fund's Board has discretion regarding whether to use NCCI's recommended loss costs.

Key Points:

- NCCI's loss cost recommendation, accepted by the Montana Insurance Commissioner, was for a 6.4% average reduction from the previous year. This is the basis for private insurers' rates.

- Montana State Fund's Board, using material from the Montana State Fund staff that was certified by the Montana State Fund's external actuary, is a 4% average reduction.

- The income, if any, due to the differential between the two reductions reportedly is to be applied to Montana State Fund's equity. - What does this mean?

Materials included here:

- Selected PowerPoint Slides taken from the MSF Class Code Rate Making Process handout. *(This provides an overview of rate-making and shows comparisons with the private insurers.)*
- A report on the NCCI Loss-Cost Filing Effective 7/1/2010. *(Page 2 notes the NCCI loss cost filing of a minus 6.4% on average and shows industry average differentiations.)*
- A "Report to Montana State Fund Board of Directors: State Auditor Review of Rates", presented by Laurence Hubbard. *(This provides an overview of the meaning behind rates that are excessive, inadequate, or unfairly discriminatory. Also included is an analysis of the pros and cons of review by the State Auditor/Insurance Commissioner.)*
- A report titled "Montana State Fund Minimum Loss Based Premium Component Expense Constant Fiscal Year 2011 Recommendation" *(This outlines components for rates charged by Montana State Fund -- the minimum loss premium, which is set at $400, and a loss-based component set at $245 and an expense constant set at $155. The bottom line is that there is no change from last year's minimum premium, loss-based component, or expense constant.)*
- A certification letter from the Montana State Fund external actuary. *(There is reference that the certification is to be relied upon by MSF and pertinent state regulatory agencies.)*

NCCI Loss Cost Filings
(LMAC created 12/2006)

Date	NCCI % Change	Premium Reduction In Millions	MSF % Change
7/1/07	-1.3%	-$ 6.1	-1.0%
7/1/08*	-4.6%	-$21.7	-3.0%
7/1/09	-2.2%	-$10.0	0.0%
7/1/10	-6.4%	-$27.8	-4.0%
4-year Total	-14.5%	-$65.5	-8.0%

*NCCI filed 2 loss cost filings in 2008 (2/1/08 and 7/1/08). The combined impact of the 2 filings was a reduction of -4.6%. The Montana State Fund Board adopted an overall premium reduction of -3.0%.

* Plan 2 followed NCCI.

MSF Class Code Use

- MSF uses 14 Special Classifications not in the NCCI inventory
  - 10 Classifications for State Agencies
  - 3 Classifications for Municipal Government
  - 1 Classification for all Agricultural class codes
- NCCI has identified 42 class codes that are materially different from MSF
  - 36 Class codes differ from NCCI by including "drivers" in the primary classification rather than a separate classification for drivers.
  - Store classifications are the primary "driver" difference.

MONTANA STATEFUND

MONTANA STATE FUND
FISCAL YEAR 2011 ANNUAL BUDGET

Approved June 25, 2010

Montana's economic situation and workers' compensation environment continually evolve. Montana State Fund's future success is dependent upon our ability to adapt to the continual changes and to adjust operational strategies in an appropriate manner. We must continue to be responsive to the needs of the Montana businesses we serve and utilize the limited resources available to us to build upon past successes and maintain a strong, viable, and stable workers' compensation market for Montana businesses.

The fiscal year 2011 (FY11) budget request provides the funding to enable Montana State Fund (MSF) to continue our role as the leader in the Montana workers' compensation industry, implement our business plan initiatives, and efficiently and effectively support business operations. The FY11 Budget will provide the financial resources to support the FY11 Strategic Business Plan (SBP).

The FY11 SBP includes nine projects encompassed within the continuing enterprise-wide initiatives of:

1) **Workforce**: recruitment, development, and retention
2) **Customer Service**: constituency education and safety culture
3) **Infrastructure**: tools to enable our employees to provide service to our customers

The budget for SBP Initiative projects is $1,171,139. The FY11 SBP provides additional detail on each initiative and the expected benefits to customers and MSF's operations.

I. Executive Summary – Statutory Operating Expense and Ratio

The FY11 Budget results in a statutory operating expense ratio attained through responsible management of the needs of MSF policyholders, injured employees, and Montana stakeholders. Based on the FY11 Annual Budget request and estimated FY11 Net Earned Premium, the estimated MSF statutory operating expense ratio is 27.80%.

The following displays net earned premiums, budget / projection / actuals, and the statutory operating expense ratios from FY08 forward to the FY11 estimates.

	FY11 Budget	FY10 Projection	FY10 Budget	FY09 Actuals	FY08 Actual
Net Earned Premiums (000)	**$153,941**	**$165,826**	**$186,520**	**$203,976**	**$230,965**
Operational Expenditures (000)	$48,204	$53,302	$56,357	$50,233	$55,524
Benefit Payments (000)	$136,715	$134,541	$133,441	$133,295	$135,124
Total Budget / Expenditures (000)	**$184,919**	**$187,843**	**$189,799**	**$183,528**	**$190,648**
Statutory Operating Expense Ratio	**27.80%**	**28.70%**	**25.44%**	**19.29%**	**19.76%**

- ✓ $25,374 - Insurance industry database and annual statement preparation software

- **Supplies: Central Stores and Other Providers** - $149,998 – this is a decrease of $34,384 or 18.6% from the FY10 projection of $184,383. This budget includes paper, toner, and a wide variety of minor office supplies.

- **Gasoline** - $61,769 – this is an increase of $13,950 or 29.2% from the FY10 projection of $47,819. The budget estimate was based on $3.259 per gallon (MSF is exempt from gas tax) for gasoline, an estimate of 22 miles per gallon on average, and an estimate of 18,953 gallons of gasoline being purchased. In FY11 MSF vehicles are projected to log 415,780 miles.

- **All Other Supplies and Materials Categories** - $259,574 - includes budget for:
  - ✓ $179,848 – asset broker – ITSD computer service charge to MSF (noted above) for enterprise software and licenses that also support MSF
  - ✓ $28,523 – promotional aids to enhance safety and other program awareness
  - ✓ $22,093 – educational materials: 'Booke' Seminar, Investment in Excellence, and 'Through the Customer's Eyes'
  - ✓ $11,467 – books & reference materials
  - ✓ $10,858 – minor office equipment
  - ✓ $5,415 - diesel fuel for back-up generator
  - ✓ $1,370 – all other

Operating Expenses - Communications

- **Postage** - $357,930 – this is a decrease of $41,175 or 10.3% from the FY10 projection of $399,105. The budget includes:
  - ✓ $228,000 - print mail service fees
  - ✓ $125,000 - meter postage
  - ✓ $4,930 – all other – meter scale updates, PO Box rental, field staff postage, postage due, and stamps

- **Advertising** (excluding recruitment advertising) - $689,672 – this is an increase of $116,299 or 20.3% from the FY10 projection of $573,734. This will provide funding for all advertising campaigns to occur in FY11; media placement, newspapers, billboards, brochures and inserts, web design, direct mail, and opportunity marketing. Television advertising is $263,158 and all other media is $426,514.

- **Employment Ads** - $30,500 – this is an increase of $7,342 or 31.7% from the FY10 projection of $23,158. This includes all in-state and out of state advertisements of MSF recruitments. This will be referenced later in the report encompassing all recruiting expenses.

- **All Telephone Categories** - $150,917 – this is a decrease of $231,580 or 60.5% from the FY10 projection of $382,497. This expense covers cell phones, long-

Fund Assessments paid to the Department of Labor and Industry, Other States Coverage (OSC) premium taxes, and property taxes on the new building.

- ✓ $194,976 - Old Fund Administrative Assessment ($170,241) and Subsequent Injury Fund Assessment ($24,736). These are regulatory assessments from the Department of Labor and Industry as provided in law. The budget is based on the invoice provided by the Department of Labor and Industry's Employment Relations Division for FY11. There will be no expense for the Rehabilitation Assessment in FY11.
- ✓ $122,640 - OSC Premium Taxes – This is for premium taxes paid for insuring MSF policyholder's operations in other states where workers' compensation premium taxes are assessed. In FY11 the OSC premiums are estimated to be $1,345,499 and the taxes and surcharges are estimated to be 9.1%.
- ✓ $5,716 - Property assessment on the new building

➢ **Education and Training** - $97,051 – this is a decrease of $13,056 or 11.9% from the FY10 projection of $110,107. MSF maintains a philosophy to provide training to employees in necessary aspects of the business to ensure corporate success. Training is needed to ensure MSF employees are knowledgeable in best practices associated with claim management, safety management and underwriting of risk.

➢ **Rewards** - $19,538 – this is an increase of $2,992 or 18.1% from the FY10 projection of $16,546. This is for employee of the month/year awards, employee referral incentives, certification awards, and IDEA awards.

➢ **Tuition Reimbursement** – $45,000 – this is an increase of $23,687 or 111.1% from the FY10 projection of $21,313. For FY11, the maximum amount of annual tuition reimbursement per employee is $4,000. Twelve employees are expected to participate in the tuition reimbursement program in FY11. Reimbursements are based on successful course completion and actual cost.

➢ **Meetings and Conference Cost** - $136,529 – this is a decrease of $19,903 or 12.7% from the FY10 projection of $156,432. The budget provides for meeting rooms and equipment for all MSF meetings that cannot be held in our building.

- ✓ Safety management workshops in locations throughout Montana
- ✓ Agent training workshops
- ✓ Marketing events throughout the state

➢ **Recruitment Expenses** (excluding Employment Advertising) - $271,875 – this is a decrease of $5,723 or 2.1% from the FY10 projection of $277,598. Employee recruitment is necessary to fill vacancies resulting from employee turnover.

Through April of FY10, MSF had 44 'recruitment actions' (includes new hires, promotions, and transfers). Each action has the potential to require different levels of expense to complete the recruitment process. The FY11 budget is based on prior year expenditures for individual recruiting actions and an expectation of lower recruiting actions being necessary in FY11.

Recruitment expenses including advertising are $302,375 and are comprised of the following accounts:

- ✓ Employment Ads - Out-of-State – $12,000
- ✓ Employment Ads - In-State – $18,500
- ✓ Relocation – Taxable – $18,930
- ✓ Recruiting – Non-Advertising - $7,095
- ✓ Job Candidate Expense – recruitment services & candidate travel expenses – $163,200
- ✓ Relocation – Non-Taxable – $82,650

➢ **Charitable Contributions / Scholarships** - $46,500 – this is a decrease of $4,270 or 8.4% from the FY10 projection of $50,770. The total funds available for charitable contributions, $46,650, were based on 0.03% of estimated FY11 net earned premium. Charitable Contributions are expended through:

- ✓ $13,850 - ACE (Assisting Charitable Endeavors) Grants program - The grants are awarded by a committee of MSF employees based on applications submitted by not for profit organizations throughout the state.
- ✓ $26,650 – Scholarship program – Scholarships of up to $2,000 per year are provided to dependents or spouses of MSF insured employees who died in work related accidents. MSF estimates 13 scholarships will be awarded in FY11 for a total budget of $26,650. Each scholarship is estimated to be $2,000 with an additional $50 administrative fee each. The budget is based on prior year participation.
- ✓ $5,000 – Leadership Montana
- ✓ $1,000 – 'Festival of Trees'

➢ **Fee Collection Expense** - $70,490 – this is an increase of $7,446 or 11.8% from the FY10 projection of $63,045.MSF contracts with three collection agencies and the fee varies based on success with collections and whether litigation is involved.

➢ **State Wide Indirect Cost** - $326,736 – this is an increase of $26,640 or 7.5% from the FY10 projection of $353,376. The State Wide Indirect Cost (also known as the State Wide Cost Application Plan or SWCAP) is an allocation determined by the Office of Budget and Program Planning as a means to allocate cost incurred by agencies whose functions support all state entities.

Equipment and Intangible Assets

The total FY11 budget for equipment and intangible assets is $141,000. This is a decrease of $3,780,293 or 96.4% from the FY10 projection of $3,921,293, as FY11 will not have the level of purchases that occurred in FY10 associated with the new building.

Equipment

➢ **Autos & Trucks** - $84,000 - Replacement vehicles as recommended by the Fleet Manager. Vehicles being replaced have reached the mileage specified in MSF's Fleet Management Policy as the replacement threshold. The budget will replace four vehicles in FY11 from our fleet of twenty-two MSF owned vehicles.

Representative Reinhart

Montana State Fund
Positions Above $80,000 in salary

POS_NO	Class Title / Salary Matrix / Grade	2013 Biennium FTE	2011 Biennium FTE	2013 Biennium Salary	2011 Biennium Salary	Sal Change	2013 Biennium Total Personal Services	2011 Biennium Total Personal Services	Change	% Change
61310001		1.00	1.00	242,000	228,797	(13,203)	270,691	255,851	(14,840)	-5.5%
	1110PO Pres/CEO-65-EE	1.00	1.00	242,000	228,797	(13,203)	270,691	255,851	(14,840)	-5.5%
61310016		1.00	1.00	124,800	124,798	(2)	146,496	147,457	961	0.7%
	1110OS VP Operations Spt-65-EE	1.00	1.00	124,800	124,798	(2)	146,496	147,457	961	0.7%
61320001		1.00	1.00	93,288	93,534	246	113,533	114,190	657	0.6%
	13203D Bus Planning-65-3D	1.00	1.00	93,288	93,534	246	113,533	114,190	657	0.6%
61320029		1.00	1.00	76,001	83,207	7,206	94,059	100,973	6,914	7.4%
	11133D Team Ldr Claim Program-65-3D	1.00	1.00	76,001	83,207	7,206	94,059	100,973	6,914	7.4%
61320110		1.00	1.00	87,489	79,918	(7,571)	107,000	98,616	(8,384)	-7.8%
	11033D Medical Leader-65-3D	1.00	1.00	87,489	79,918	(7,571)	107,000	98,616	(8,384)	-7.8%
61320112		1.00	1.00	83,556	83,357	(199)	101,961	100,644	(1,317)	-1.3%
	11103E Team Ldr-Lg-65-3E	1.00	1.00	83,556	83,357	(199)	101,961	100,644	(1,317)	-1.3%
61320151		1.00	1.00	82,224	74,439	(7,785)	101,069	92,350	(8,719)	-8.6%
	15153C Software Engineer III-65-3C	1.00	1.00	82,224	74,439	(7,785)	101,069	92,350	(8,719)	-8.6%
61320501		1.00	1.00	83,017	79,789	(3,228)	101,357	97,987	(3,370)	-3.3%
	13303C Senior Underwriter-65-3C	1.00	1.00	83,017	79,789	(3,228)	101,357	97,987	(3,370)	-3.3%
61330001		1.00	1.00	136,999	135,198	(1,801)	159,423	156,509	(2,914)	-1.8%
	1110OP VP Operations-65-EE	1.00	1.00	136,999	135,198	(1,801)	159,423	156,509	(2,914)	-1.8%
61330019		1.00	1.00	96,217	93,152	(3,065)	116,130	113,190	(2,940)	-2.5%
	11103E Team Ldr-Lg-65-3E	1.00	1.00	96,217	93,152	(3,065)	116,130	113,190	(2,940)	-2.5%
61330029		1.00	1.00	82,393	79,189	(3,204)	100,660	99,081	(1,579)	-1.6%
	41303C Team Ldr-Mkt Dev-65-3C	1.00	1.00	82,393	79,189	(3,204)	100,660	99,081	(1,579)	-1.6%
61330034		1.00	1.00	87,761	88,398	637	106,667	107,781	1,114	1.0%
	13303D Team Ldr Underwriting Svcs-65-3D	1.00	1.00	87,761	88,398	637	106,667	107,781	1,114	1.0%
61330040		1.00	1.00	84,469	81,186	(3,283)	103,857	104,100	243	0.2%
	29913D Team Ldr-Sfty Services-65-3D	1.00	1.00	84,469	81,186	(3,283)	103,857	104,100	243	0.2%
61330076		1.00	1.00	94,617	91,725	(2,892)	114,340	110,024	(4,316)	-3.8%
	11103E Team Ldr-Lg-65-3E	1.00	1.00	94,617	91,725	(2,892)	114,340	110,024	(4,316)	-3.8%
61330077		1.00	1.00	100,553	96,641	(3,912)	120,803	117,124	(3,679)	-3.0%

	11103E Team Ldr-Lg-65-3E	1.00	1.00	100,553	96,641	(3,912)	120,803	117,124	(3,679)	-3.0%
61330901		1.00	1.00	101,059	97,129	(3,930)	121,337	121,772	435	0.4%
	23104A Assistant General Counsel-65-4A	1.00	1.00	101,059	97,129	(3,930)	121,337	121,772	435	0.4%
61340001		1.00	1.00	145,001	141,439	(3,562)	167,904	176,643	8,739	5.2%
	1110GC General Counsel-65-EE	1.00	1.00	145,001	141,439	(3,562)	167,904	176,643	8,739	5.2%
61340002		1.00	1.00	108,566	103,918	(4,648)	129,293	123,309	(5,984)	-4.6%
	23114A Legal Counsel-65-4A	1.00	1.00	108,566	103,918	(4,648)	129,293	123,309	(5,984)	-4.6%
61340003		1.00	1.00	92,780	89,824	(2,956)	112,284	107,892	(4,392)	-3.9%
	23103D Claim Attny-65-3D	1.00	1.00	92,780	89,824	(2,956)	112,284	107,892	(4,392)	-3.9%
61340004		1.00	1.00	92,891	90,051	(2,840)	112,408	108,148	(4,260)	-3.8%
	23103D Claim Attny-65-3D	1.00	1.00	92,891	90,051	(2,840)	112,408	108,148	(4,260)	-3.8%
61340005		1.00	1.00	94,680	91,665	(3,015)	114,411	115,608	1,197	1.0%
	23103D Claim Attny-65-3D	1.00	1.00	94,680	91,665	(3,015)	114,411	115,608	1,197	1.0%
61340011		1.00	1.00	87,040	82,221	(4,819)	105,859	99,372	(6,487)	-6.1%
	23103D Claim Attny-65-3D	1.00	1.00	87,040	82,221	(4,819)	105,859	99,372	(6,487)	-6.1%
61350001		1.00	1.00	146,540	146,325	(215)	169,534	179,965	10,431	6.2%
	1110CS VP Corp Spt-65-EE	1.00	1.00	146,540	146,325	(215)	169,534	179,965	10,431	6.2%
61350008		1.00	1.00	93,319	91,131	(2,188)	112,887	110,890	(1,997)	-1.8%
	11103E Team Ldr-Lg-65-3E	1.00	1.00	93,319	91,131	(2,188)	112,887	110,890	(1,997)	-1.8%
61350026		1.00	1.00	68,116	89,894	21,778	85,384	118,023	32,639	38.2%
	11123B Team Ldr DPF-65-3B	1.00	1.00	68,116	89,894	21,778	85,384	118,023	32,639	38.2%
61350057		1.00	1.00	87,160	84,075	(3,085)	105,995	101,449	(4,546)	-4.3%
	11303E Finance Team Leader-65-3E	1.00	1.00	87,160	84,075	(3,085)	105,995	101,449	(4,546)	-4.3%
61350058		1.00	1.00	99,861	95,977	(3,884)	120,796	115,362	(5,434)	-4.5%
	15203E Internal Actuary-65-3E	1.00	1.00	99,861	95,977	(3,884)	120,796	115,362	(5,434)	-4.5%
61360001		1.00	1.00	119,999	109,198	(10,801)	141,409	128,913	(12,496)	-8.8%
	1110HR VP HR-65-EE	1.00	1.00	119,999	109,198	(10,801)	141,409	128,913	(12,496)	-8.8%
61360008		1.00	1.00	86,547	85,504	(1,043)	105,308	103,052	(2,256)	-2.1%
	27303D Team Leader-Comm-65-3D	1.00	1.00	86,547	85,504	(1,043)	105,308	103,052	(2,256)	-2.1%
61360010		1.00	1.00	89,860	86,151	(3,709)	109,016	103,775	(5,241)	-4.8%
	11103E Team Ldr-Lg-65-3E	1.00	1.00	89,860	86,151	(3,709)	109,016	103,775	(5,241)	-4.8%
61360012		1.00	1.00	80,001	34,487	(45,514)	97,981	46,072	(51,909)	-53.0%

Who Pays Benefits to Injured Workers if a Payer Goes Bankrupt in Montana?

- **Plan 1- Self-Insured Employers** – Self Insurance Guaranty Association (not true for public self-insured entities)
- **Plan 2 – Private Insurers** – Insurer's Guaranty Association
- **Plan 3 – Montana State Fund** – All Montana taxpayers

How the CSI regulates Plan 2 Insurers:

•Rate Review

- Reviews every insurance policy to be used by companies for compliance with Montana law.
- Reviews rates to ensure actuarial data supports the rates to be charged by insurance companies.
- CSI has a full-time Qualified Property/Casualty Actuary on staff.

•Examinations

- Reviews financial affairs of domestic insurers to ensure companies are solvent.
- Each insurer is required by law to be examined once every three to five years.
- Ensures compliance, oversees rehabilitation or liquidation.
- Reviews guaranty funds to see who contributes and who recovers.
- CSI has two full-time Certified Financial Examiners on staff.

•Market Conduct

- Performs market conduct examinations to ensure compliance with state laws regulating the sales and marketing, underwriting and issuance of insurance products.
- CSI has on staff one Certified Insurance Examiner and two full-time Accredited Insurance Examiners.

CSI: 840 Helena Avenue, Helena, MT 59601
Contact: Jackie Boyle, 444-3152, jboyle@mt.gov

1-800-332-6148 (406) 444-2040

www.csi.mt.gov

Monica J. Lindeen
CSI
Montana Commissioner of Securities & Insurance

Regulatory Authority Over State Funds

State	Regulatory Authority
Idaho	Department of Insurance -subject to same regulation as private insurers
Montana	Governor appoints board; management and control vested solely in the Board
New Mexico	Sup. of Ins.-subject to same regulation as private insurers
North Dakota	Separate state agency; Governor appoints Board and head of agency; subject to biennial performance audit by State Auditor
Oregon	Governor appoints board/approval of Senate; subject to annual audit /reporting to the Secretary of State
Washington	Division of Department of Labor and Industry; Annual Audit of financial statements by State Auditor
Wyoming	Division of the Department of Employment

Rating Provisions	**Board sets rates subject to review or regulation by Department of Insurance**															
	State	AZ	CA	CO	HI	ID	KY	ME	MO	NM	OR	RI	TX	WV		
	Ore. Index Rank	45th	13th	43rd	36th	34th	7th	5th	28th	32nd	39th	26th	17th	41st		
	Board sets rates not subject to review but board includes state officials (PA no ranking on HHI index)															
	State	LA	NY	OK	PA	UT										
	Ore. Index Rank	11th	19th	9th	15th	46th										
	Board sets rates not subject to review by regulator															
	State	MT														
	Ore. Index Rank	2nd														
	State Agency sets rates (SC no ranking on HHI index)															
	State	MN	ND	NJ	OH	SC	WA	WY								
	Ore. Index Rank	24th	51st	16th	3rd	12th	38th	37th								
Regulator	**Board with political appointees and by statute** (PA no ranking on HHI index)															
	State	CA	ID	MD	MT	NY	OK	OR	PA	TX	UT					
	Ore. Index Rank	13th	34th	44th	2nd	19th	9th	39th	15th	17th	46th					
	Board under regulatory authority of the Insurance Commissioner/Department of Insurance															
	State	AZ	HI	ME	MO	NJ	NM	OR	RI	TX	WV					
	Ore. Index Rank	45th	36th	5th	28th	16th	32nd	39th	26th	17th	41st					
	State Agency (not independent) (Minnesota is for the assigned risk pool)															
	State	MN	ND	OH	WA	WY										
	Ore. Index Rank	24th	51st	3rd	38th	37th										

Review of State Funds' Regulation

To: **Economic Affairs Committee Members**
From: **Pat Murdo, Staff**

The following Table reviews 27 states, of which 25 have some form of a State Fund, defined here as an entity set up by the state as a nonprofit, independent, and quasi- public or public provider of workers' compensation insurance. In some cases these have changed to be an assigned risk pool or a mutual independent insurance company with publicly appointed members. In others they are no longer state-related. Minnesota and New Jersey may or may not have State Funds that fit the description above. Research was by phone call, email, and statute review, and it continues.

The following format used to review the State Funds was based on questions from the committee about regulation and on issues investigated by the Legislative Audit Division in the Corporate Governance Report. States may be listed under more than one criteria or not at all if details on the heading were not found. Market share is provided as an indication of the fund's market strength. Data is from 2007. See note at end.

State Fund Names
System/Type of Market
- Monopolistic -- ND, OH, WA, WY
- Assigned Risk -- AZ, HI, ID, NM, OR
- Guaranteed Market -- CA, CO, KY, LA, ME, MD, MT, NY, OK, PA, RI, UT
- Not Clear -- MO, SC, WV (TX is a voluntary market - work comp is not required.)

Rating Provisions
- Board sets rates subject to review or regulation by Dept. of Insurance -- AZ, CA, CO, HI, ID, KY, ME, MO, NM, OR, RI, TX, WV
- Board sets rates not subject to review but board includes state officials -- LA, NY, OK, PA, UT
- Board sets rates not subject to review -- MD, MT
- State Agency sets rates -- ND, OH, SC (?), WA, WY

Regulator
- Board with political appointees and by statute -- AZ, CA, ID, MD, MT, NM, NY, OK, OR, PA, TX, UT, WV
- Board under regulatory authority of the Insurance Commissioner/Dept of Insurance -- AZ, HI, ME, MO, NM, OR, RI, TX
  - of which 7 are mutual insurers not considered a state agency -- AZ, HI, ME, MO, NM, RI, TX
- State Agency (not independent) -- ND, OH, WA, WY

Auditor
- Examinations or audits by Insurance Commissioner/Other Executive Branch Agency -- AZ, CA, ID, KY, MD, MO, NY, OH, OR, RI, TX, UT
- Subject to filing annual statements with legislature or governor or Dept. of Insurance -- KY, ME, MD, MO, MT, NY, OH, OK, RI, WV, WY
- Subject to independent actuary or audits -- HI, MO, MT, OH, OK, PA
- Audits by Legislative/State Auditor/others -- CO, MT, NM, ND, OR, TX, UT, WA

Investor
- Board/Company -- AZ, CA, HI, KY, ME, MO, NM, OK, TX, UT
- State Agency (i.e. State Treasurer or other) -- CO, ID, MT, OH, PA, WA
- Mix -- NY

MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

Room 110 Capitol Building * P.O. Box 201711 * Helena, MT 59620-1711 * (406) 444-2986 * FAX (406) 444-3036

Director
AMY CARLSON

DATE: May 18, 2010

TO: Economic Affairs Interim Committee

FROM: Kris Wilkinson, Fiscal Analyst II

RE: Costs Related to Regulation of Montana State Fund

As part of its review of the workers' compensation insurance system in Montana, the Economic Affairs Interim Committee (EAIC) requested information on the costs incurred by Montana State Fund (MSF) for audits and actuarial reviews. The following outlines the costs incurred by MSF and the Legislative Audit Division (LAD) for audits and actuarial reviews in the last four years.

Both MSF and LAD contracts for auditing and actuarial services for MSF. A summary of the various costs is provided in the following figures:

- Figure 1 provides the costs for auditing fees recorded on the state's accounting records for MSF over the last 4 years
- Figure 2 gives the additional costs paid from the general fund for LAD audits of MSF
- Figure 3 shows the MSF contracted actuarial costs
- Figure 4 provides LAD contracted actuarial cost of MSF

Audits

Figure 1
Montana State Fund
Auditing Costs Recorded on SABHRS

Description	FY 2007	FY 2008	FY 2009	FY 2010*
LAD Audit Costs	$21,375	$46,344	$16,924	$42,292
Statutory statement audit	33,000	25,855	22,300	34,480
Contracted Policyholder Premium/Payroll	892,802	876,097	909,508	596,808
Pharmacy Benefit Manager	0	58,000	0	0
Other Audits	8,499	0	0	0
	$955,676	$1,006,296	$948,732	$673,580

* Financial information as of May 17, 2010

MSF's auditing costs have been approximately $1.0 million a year. The majority of the costs are for MSF contracts with private firms to conduct policyholder premium and payroll audits. As shown, MSF has two financial statement audits conducted each year:

- LAD financial compliance audit – the statutorily required audit of MSF books as recorded on the state's accounting system. The audit includes evaluations of the claims reservation process, the amounts reserved, and the current report of the MSF's independent actuary
- Contracted statutory statement audit – an audit of MSF financial statements presented in a manner comparable to other workers' compensation insurance companies

In addition to the statutorily required annual financial compliance audits, the Legislative Audit Division (LAD) also conducted:

- o Performance audit of MSF governance
- o Information system audit of MSF's policyholder system

While financial and compliance audits are budgeted and appropriated costs to each agency, funding for performance audits and information system audits is funded from the general fund and, in most cases, not billed to an agency. According to LAD, the costs of the additional audits were:

Figure 2
Legislative Audit Division
Additional Audit Costs for MSF
November 2007 - November 2009

Audit Number	Audit Title	Type of Audit	Date Issued	Audit Cost
07SP-14	Policy Holder System	Information Systems	Nov-07	$20,974
08P-08	Corporate Governance Practices	Performance	Feb-09	71,720
Total				$92,694

The costs of the additional audits were borne by the general fund appropriated to LAD.

Actuarial Reviews

Independent actuarial reviews are another significant cost for MSF. MSF contracts with a qualified independent actuary to:

- Provide analysis of loss and loss adjustment expense reserve indications
- Determine the reasonableness and actuarial fairness of MSF's tier rating structure
- Provide an analysis of overall manual rate changes
- Provide analysis in selecting loss cost multipliers
- Review actuarial procedures and methods to develop class rates for MSF state special codes and for limited deviations from the National Council on Compensation Insurance loss costs

The costs of contracting for these services are shown in Figure 3.

Figure 3 MSF - Contacted Actuarial Costs			
Fiscal Year	New Fund	Old Fund	Total
FY 2008	$73,493	$14,612	$88,105
FY 2009	192,720	59,595	252,315
FY 2010*	164,126	41,926	206,052
Total	$430,339	$116,133	$546,472

In addition, statute requires LAD to review workers' compensation rates set by the Montana State Fund Board of Directors to determine if they are excessive, inadequate, or unfairly discriminatory. The review of the rates is conducted by an independent actuary that reviews the work of the independent actuary contracted by MSF. The costs of the actuarial review contracted by LFD are presented in Figure 4.

Figure 4 LAD Contracted Actuarial Costs of Montana State Fund November 2007 - November 2009				
Contract Number	Actuarial Opinion Title	Type of Service	Date Issued	Actuary Cost
07C-04	MSF Actuarial Review FY07	Contract	Nov-07	$9,500
08C-04	MSF Actuarial Review FY08	Contract	Nov-08	9,500
09C-03	MSF Actuarial Review FY09	Contract	Nov-09	8,500
	MSF Actuarial Review FY 10	Contract		8,500
Total				$36,000

The review includes:

- Analysis of the rate setting process
- Analysis of the process for setting the overall rate level and rates by class
- The reasonableness of data, formulas, and methodology used in claims reservation process, the amounts of the estimated claims reserves and amounts carried on the financial statements using, to the extent possible, an analysis of MSF's contract actuary's work
- Review of the procedures to assess the validity of information obtained from MSF, determine the reliance placed on the information, and the procedures used to assess the validity of the information
- Review of the data elements used in the rate setting process and the estimation of claims liability

The legislature's role in creating the Old Fund and the New Fund

Background

Between 1987 and 1993 the legislature wrestled with major issues in our state's workers' compensation system. At the core was an unfunded liability of more than $500 million in claim benefits due to injured employees. During the 1980s, workers' compensation insurance premium rates were influenced by the political process rather than actuarially sound analysis. Rates were set at artificially low levels even as payouts increased. Because losses far exceeded premiums collected, the unfunded liability grew at a staggering rate, jeopardizing the entire system. In addition, the underpriced market essentially forced private carriers—who could not remain competitive and still profitably write coverage—to leave the state. Their departures meant that Montana businesses had fewer options for their insurance and placed a greater burden on a flawed system. Once it became clear that the structure was no longer workable, the legislature found it necessary to intervene. During the 1987 session, they made the difficult and unpopular decision to enact a 0.3% payroll tax on employers to raise revenues. However, stricter measures needed to be taken.

In 1989, one of the most critical issues confronting the legislature was trying to bring some semblance of order back into the workers' compensation system. Recognizing that the state's workers' compensation system was in need of a major overhaul, the legislature created a new entity, the State Compensation Mutual Insurance Fund (State Fund). State Fund was structured to operate as a domestic mutual insurance company, and as such, function independently of state agency requirements.

In order to bring more revenue into the system, rates for workers' compensation coverage needed to rise dramatically. However, there was tremendous resistance to rate increases of the magnitude that would be needed to effectively deal with the problem. In June 1989, there was a special session convened that appropriated $20 million of the General Fund to State Fund.

Saddled with mounting liabilities, State Fund would need a dramatic increase in rates to achieve balance in the system. The uproar created was vocal and swift. Increases of this magnitude would be devastating to existing or new businesses in Montana, and were simply unacceptable. It was increasingly apparent that a bold, innovative solution needed to be found to resolve the crisis once and for all.

The legislature reconvened in a special session in May 1990 and took a different approach. Realizing that saddling State Fund with an astronomical debt was unworkable, the legislature separated the liability into claims occurring before and after July 1, 1990. Claims occurring before this date became known as the Old Fund. Any claims after that date became the responsibility of the New Fund (now known as Montana State Fund, or MSF). In doing this, the state determined that the Old Fund liabilities would be funded by an increased payroll tax on employers and employees. Bonds were sold to cover the unfunded liability and were serviced by proceeds from the payroll tax. MSF administers the Old Fund on behalf of the legislature (MSF is reimbursed for the cost of administering the claims) but has no liability or funding responsibilities. It was the intent of the legislature that Montana State Fund be run in a business-like manner, solely funded through insurance premiums and investment income. MSF began operations on July 1, 1990.

- *HB 363 removed the reserve requirements from the Old Fund and transferred $18.2 million, as well as any future excess, to the General Fund from the Old Fund.*
- *SB 304 created an interim committee to study the structure and role of MSF, and if it would be in the best interest of the state to sell either the Old Fund or the New Fund. The committee was tasked with making recommendations to the 2005 legislature.*
- *SB 360 stipulated that the legislature cannot transfer monies from Montana State Fund to be used for other funds or other programs.*

There are approximately 900 open claims remaining in the Old Fund, with estimated obligations of $71.1 million as of June 30, 2010. Actuarial predictions are that the final claim will not be paid out until 2049. When the funds in the Old Fund are depleted, the state of Montana and the General Fund are obligated to cover any benefit payments. The unfunded liability as of June 30, 2010, was estimated at $48.1 million. However, the Old Fund financial statements are prepared on a present value basis, as required by Montana law. Because the Old Fund does not have sufficient assets to cover claim liabilities, the Old Fund will not earn the necessary investment income over time that is implicitly assumed in a present value discount. We estimate that, as of June 30, 2010, the Old Fund will require general fund support totaling $60.8 million over the next 40 years.

Old Fund reserves are estimated to be depleted in FY 2011.

The Old Fund liability of $500 million was financed through a combination of payroll tax collections (68%) and monies transferred from MSF (32%). The key events are:

1989

$20 million appropriation of General Fund money to the Old Fund.

1987 – 1998

$349 million in payroll tax collections.

1996 – 1998

$166 million paid by Montana State Fund to eliminate the Old Fund liability and allow for payments of dividends to policyholders. In recognition of the payment, legislature allowed for any excess beyond actuarial projection in Old Fund to be transferred back to MSF.

1997 – 1998

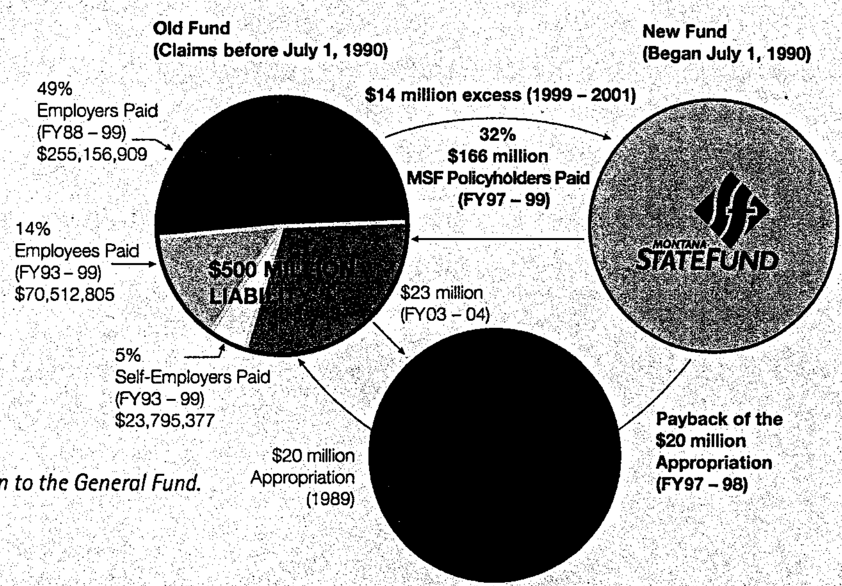
MSF paid back the 1989 appropriation of $20 million to the General Fund.

1999 – 2001

$14 million in excess returned to MSF.

2002 – 2003

$23 million transferred as legislature determined that all existing contingency reserves and any excess from Old Fund should go to General Fund.



- *$800,000 of Old Fund excess transferred to General Fund for a total of $23 million.*
- *SB 61 created legislative liaisons to MSF board. Two legislators were appointed as non-voting liaisons to the board. They attend all meetings and receive all board materials. The SB 304 committee determined there would be no sale of MSF and therefore maintained the current structure of MSF as a public, nonprofit competitive state fund with the responsibility of being the guaranteed market for Montana businesses.*

2003 regular legislative session

2005 regular legislative session

2007 Montana Legislature

About Bill -- Links

HOUSE BILL NO. 757

INTRODUCED BY D. RICE

A BILL FOR AN ACT ENTITLED: "AN ACT REVISING LAWS RELATED TO THE STATE COMPENSATION INSURANCE FUND; LIMITING THE AUTHORITY OF THE BOARD OF DIRECTORS OF THE STATE COMPENSATION INSURANCE FUND; REVISING THE METHOD FOR CALCULATING PAYROLL ON WHICH PREMIUMS ARE BASED; AMENDING SECTIONS 39-71-2316 AND 39-71-2336, MCA; AND PROVIDING AN EFFECTIVE DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 39-71-2316, MCA, is amended to read:

"39-71-2316. Powers of state fund. (1) For the purposes of carrying out its functions, the state fund may:

(a) insure any employer for workers' compensation and occupational disease liability as the coverage is required by the laws of this state and, as part of the coverage, provide related employers' liability insurance upon approval of the board;

(b) sue and be sued;

(c) enter into contracts relating to the administration of the state fund, including claims management, servicing, and payment;

(d) collect and disburse money received;

(e) adopt classifications and charge premiums for the classifications so that the state fund will be neither more nor less than self-supporting. Premium rates for classifications may be adopted and changed only by using a process, a procedure, formulas, and factors set forth in rules adopted under Title 2, chapter 4, parts 2 through 4. After the rules have been adopted, the state fund need not follow the rulemaking provisions of Title 2, chapter 4, when changing classifications and premium rates. The contested case rights and provisions of Title 2, chapter 4, do not apply to an employer's classification or premium rate. The state fund is required to belong to a licensed workers' compensation advisory organization or a licensed workers' compensation rating organization under Title 33, chapter 16, part 4, and may use the classifications of employment adopted by the designated workers' compensation advisory organization, as provided in Title 33, chapter 16, part 10, and corresponding rates as a basis for setting its own rates. Except as provided in Title 33, chapter 16, part 10, a workers' compensation advisory organization or a licensed workers' compensation rating organization under Title 33, chapter 16, part 4, or other person may not, without first obtaining the written permission of the employer, use, sell, or distribute an employer's specific payroll or loss information, including but not limited to experience modification factors.

(f) pay the amounts determined to be due under a policy of insurance issued by the state fund;

(g) hire personnel;

(h) declare dividends if there is an excess of assets over liabilities. However, dividends may not be paid until adequate actuarially determined reserves are set aside.

(i) adopt and implement one or more alternative personal leave plans pursuant to 39-71-2328;

(j) upon approval of the board, contract with licensed resident insurance producers;

(k) upon approval of the board, enter into agreements with licensed workers' compensation insurers, insurance associations, or insurance producers to provide workers' compensation coverage in other states to Montana-domiciled employers insured with the state fund;

~~(l) upon approval of the board, expend funds for scholarship, educational, or charitable purposes;~~

~~(m)~~(l) upon approval of the board, including terms and conditions, provide employers coverage under the federal Longshore and Harbor Workers' Compensation Act, 33 U.S.C. 901, et seq., the federal Merchant Marine Act, 1920 (Jones Act), 46 U.S.C. 688, and the federal Employers' Liability Act, 45 U.S.C. 51, et seq.;

~~(n)~~(m) perform all functions and exercise all powers of a private insurance carrier that are necessary, appropriate, or convenient for the administration of the state fund, except that neither the state fund nor the board may authorize the payment of employee bonuses or incentives or authorize activities unrelated to the administration of the state fund.

(2) The state fund shall include a provision in every policy of insurance issued pursuant to this part that incorporates the restriction on the use and transfer of money collected by the state fund as provided for in 39-71-2320."

Section 2. Section 39-71-2336, MCA, is amended to read:

"39-71-2336. Manner of electing -- contract or policy of insurance -- payment of premium. (1) (a) The state fund shall prescribe the procedure by which an employer may elect to be bound by compensation plan No. 3, the effective time of the election, and the manner in which the election is terminated for reasons other than default in payment of premiums.

(b) Every employer electing to be bound by compensation plan No. 3 must receive from the state fund a contract or policy of insurance in a form approved by the department.

(c) All Montana operations of an employer, as defined in 39-71-117, covered by compensation plan No. 3 must be insured by the state compensation insurance fund. The premium must be paid by the employer to the state fund at times that the state fund prescribes and must be paid over by the state fund to the state treasurer to the credit of the state fund.

(2) The estimated payroll on which premiums are based and used for a renewal policy may not be determined by applying an automatic increase."

NEW SECTION. **Section 3. Effective date.** [This act] is effective July 1, 2007.

- END -

Latest Version of HB 757 *(HB0757.01)*

Processed for the Web on February 17, 2007 (11:51am)

New language in a bill appears underlined, deleted material appears stricken.

Sponsor names are handwritten on introduced bills, hence do not appear on the bill until it is reprinted.

See the status of this bill for the bill's primary sponsor.

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